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A note on Reaganomics[@]

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According to Keynes' General Theory, under less than full employment conditions, changes in the quantity of money generate effect upon investment through the rate of interest and then the aggregate quantity demanded. Once full employment was achieved, increase in money supply would fully be reflected in prices. The U.S. economy which reached the stage of full employment long time ago was in a position to control price inflation within limits because much of enterpreneurial efforts were directed towards raising productive efficiency of the economy, which led to a situation that increased prices were more than made up by output rise leading to higher savings and higher investment. The U.S economy specially after serious involvement in the Vietnam conflict has been in a mess which continues even today. The present economic outcome seems to have evolved thus :

Higher government spending through printing money creates an excess demand for resources including labour which brings about a rise both in cost and prices. Initially, price inflation gives rise to windfall profits to the business community as a result of which business expectations bounce up.With rising business expectations, investor's demand for credit rises thus raising the interest rate. High interest rate in turn raises cost of investment & price thereafter. As prices soar up, workers demand for higher wage will exert both demand-pull & cost-push inflaton in the economy. Rising prices willcontinue to erode purchasing value of money, so the cost of government financing as well as living cost of people rise when government will resort to more deficit

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spending to maintain real expenditure, people will try to adjust by using up nontransaction money for transaction purposes so as to maintain real standard of living which while maintaining excess demand in the economy keeps business still profitable. As business expectations are still high, demand for credit rises but since people's savings have gone down, investible fund will be scarcer which has the effect of causing interest rate to rise further. Higher interest rate once again pushes cost of investment upward and therefore,prices of new output in the market as well. Prices rise by leaps & bounds because higher inflationary rise in prices would make people spend abnormally high. Thus greater rise in price not only leads to impairment of purchasing capacity but would also affect adversely savings of people. Financial institutions will have to face with problems of falling deposits by raising the rate of interest.But even by doing so, sufficient savings will not be generated in the economy. As funds grow scarcer & scarcer interest rate will soar higher & higher, which has the effect of raising cost of investment. Higher cost will induce enterpreneums to adopt more capital intensive techniques which will be started initially in one or a few sectors to beat rising costs thus preventing business expectation from sagging for some time. This, however, spreads over all sectors, consequences like decline in the share of labour income with its dampening effect on aggregate demand, will take place to cause 'recession' in the economy.

Moreover, when inflation occurs by leaps and bounds two things will put the economic house out of order: First, greater rise in price will reduce purchasing power of money fastly bringing about a situation of monetary deficit as a result of which most of the existing stocks of goods will have to remain unsold inflicting severe losses to the business community. Secondly, declining savings will render scope for investible funds all the more smaller which raises interest rate greatly. Higher interest rate once again will be the cause of higher cost and prices. These two things liks monetary deficit causing losses and rising cost of investment will be strong enough to shatter the business confidence. Once this happens, not only new investment will be hard and few but even the existing capacity of the economy will remain much below full capacity utilisation leading to labour retrenchment and more unemployment.

The present U.S. economic crisis if we draw from Keynes' "How to Pay for the War (1940)" may have been due to the fact that "government spending without measure to curtail private spending created excess demand which might lead to price increase in turn leading to wage demands, in turn causing price increases. If Keynesion prescription, that prescribes measures interalia, like drawing excess balance by means of deferred tax credits known as 'Post-WarCredit' which were to be repaid immediately after war when it was confidently expected that

there would be severe shump", had been used, the crisis could have been averted. By contrast, according to Robin Moris, Chairman, University of Maryland, U.S. government attempted to engage in the Vietnam conflict with a peace economy, lack of political courage and little in the way of control. "In the circumstances it is a measure of the production power of the United States system that inflation was not much more severe than it was Nevertheless, as already indicated, there are many who believe that the present inflation basically has its roots in years of the late 1960s. Excess demand, caused by the conflict (the argument goes), set a train of wage increases, which caused price increases, which in turn caused the growth of the inflationary expectations that are still with us today".

"In brief, the present U.S. economic mess has been due to overheating of the economy, not financed through mobilisation of resources, much diversion of resources to Vietnam war, raising the prices, leading to raising demand which is unnatural, when prices rise and cost rise, raw materials supply become insufficient, inflation sets in, unemployment rises a new situation called stagflation ensued which means decelerating output, rising prices and falling employment".

To counter stagflation two completely differing views have emerged quite recently. President of the United States of America relies on spending cut, tax concessions and higher interest rate where as President Mitterand of the Republic of France deems deficit spending and lower interest rate as necessary medication.

According to Lester C. Thurow, an American economist, the possibility of speeding up economic growth by stepping on monetary brakes to decelerate inflation while stepping on the fiscal accelerator with large tax cuts and sharp increase in defence spending, is effectively zero. The opinion that "Tight Money always stops growth whatever be its effects on inflation. With high growth choked off by high interest rate, budget deficits are going to be bigger. The result is more demand for credit and higher interest rates (Newsweek, Sept. 21, 1981). Three Reagan administration economists conceded that the administration may be facing larger deficits than it has projected (The Economic Times Indian Daily. Oct. 22, 1981). The Professor, Tobin is also of the opinion that the U.S. is likely to experience "Considerable economic pain and damage for several years and other federal reserve attempts to wrong inflation out of the economy". In his opinion "the purely monetary cure to inflation can hold down the economy for half the decade with capital formation discouraged either by high real interest rate with gloomy profit calculations or both". Another eminent American economist John K. Galbraith said that the

U.S. President Ronald Reagan had incorporated in his monetary policy "all the old elements of failure in somewhat exaggerated form. It proposes an even greater reliance on monetary policy an even larger deficit and anabandonment of the primitive efforts at direct intervention on wages and prices, which had been to a limited extent a part of the Carter policy". He said "Apart from the uncertainty of action and effect, the reliance on monetary policy has other adverse consequences; it descriminates sharply against those industries, housing being a notable case, which rely on borrowed money. Larger Corporations with capital from earnings and the ability to pass costs along in price are much less affected as it is through a reduction in investment outlays, Monetary policy has an entirely adverse effect on productivity".

To repeat once again on the one hand, excess demand created through high spending through deficits by raising prices excessively reduces purchasing value of money which ultimately take us to a situation of monetary deficit in the economy where the existing stocks will remain unsold thus infliting heavy losses to the business community. On the other rising prices lead to depletion of savings which by affecting high interest rate cause costs and prices to rise. This will limit the growth of new investment and therefore output in the economy. The result: Prices will increase further depending upon the availability of goods on the one hand and cash balances to purchase those goods on the other. Thus a situation of some permanent monetary deficit for goods and services seems to emerge in the economy. Under this circumstance, Ronald Reagan's economic polices particularly concerning that of restricting money supply growth undoubtedly may go to bring down excess demand, but since higher interest rate also raises costs of new investment, and therefore growth of output as well, the problem seems to remain largely unsettled.

However, Ronald Reagan's overall economic policies like government spending cut, tax concessions and high interest rates also seems to be quite conflicting with each other as a consequence of which the chances of reviving the economy have dwindled. For instance, on the one hand, high interest rates by inducing people to save more kills one of the intended affect of the spurting up demand through tax concessions. Less spending by people when combined with cut in government spending generates demand deflation as a consequence of which business profits slumps. With falling profits business expectations will decline. Higher interest rates on the other hand defeats another objective like curbing inflation because higher interest rate means higher costs and prices and not vice-versa. Higher interest rates, therefor, being an important instrument to demand deflation and to rising cost will discourage new investment and not encourage it.

Lester C. Thurow therefore suggests that the President should try to bring down interest rate by reversing the strategy i.e. tightening fiscal policies and loosening monetary policies. To produce budgetary surplus in 1982, he proposed a large tax increase which may be in the form of value-added tax (VAT)-a form of national sales tax . Since Thurow's policy measure of imposing VAT has the same inherent quality of raising prices similar to that of effect of maintaining high interest rates, new investment cannot be expected to rise.

Some measures like combination of large government spending, lower interest rate and tax concessions may, therefore, seem to be quite essential in my opinion,. The recent newspaper report of likely interest rate cut therefore seems to be a step in the right direction. (The Economic Times, Indian Daily, Nov. 3, 1981). Overall spending may rise with higher government spending and higher spending from tax cuts induced by a lower interest rate. With aggregate demand rising, existing stocks of goods will be sold out which will not only minimise the losses for the businessmen but also provide more investible funds to them. As demand picks up, business expectations brightens up and new investment will be encouraged because of lower cost due to lower interest rate. As more output becomes available at lower prices, purchasing value of money gradually moves up. With lower inflation rate, real income rises which leads to increase in savings and consequently to investment in the economy. Once business confidence is restored, investment, employment, income etc. should look up. However, proper care must be taken to insure that new investment wherever possible should not be directed towards more capital intensive technology. Otherwise shrinkage in labour income creates a sort of demand deficiency which may lead the economy back again to recession phase. However as the economy picks up, need for large deficits the government spending will not be necessary as it may become possible now to finance through mobilisation of more tax money.

Book Review

S. C. Jain, Poverty to Prosperity in Nepal, Delhi: Development Publishers, 1981, 114pp. tables, index, Price: I Rs. 50/– or U.S. $ 30.00.

The main objective of the book **"Poverty to Prosperity in Nepal"** is in the words of S.C. Jain, "to highlight poverty problem in Nepal along with programmes and policies for reducing its magnitude."

The book is divided into 6 chapters. Chapter 1 presents in detail summary of the book. Chapter 2 presents criteria for determining poverty line of Rs. 2.00 person per day. Below this line are the absolute poors and abore this and below Rs. 2.68 are the relative poors. Rupees 2.68 is the rational average per capita daily consumption expenditure. The distinction of well-to do among rich and the affluent having above the national average per capita daily consumption expenditure should have been within the scope of the book since this would reflect prosperity aspect more clearly than the author realised. This would also give an idea of income diffential between the rich and the poor. Chapter 3 gives the estimates of households and population of absolute and relative poor by ecological regions as well as by development regions. Chapter 4 highlights the economic characteristics of the poor population below the poverty line. The analysis of the population above the poverty line is excluded because of data not available. Economic characteristics of the absolute poors included are: Share in the aggregate income, distribution, under different income classes, daily calorie intake, average operated area, under-employment level by rural household and rural worker. Chapter 5 gives projection of poverty within the period 1980 on the basis of total population and households for both absolute and relative poors. The author recommends in the final chapter policies for reducing poverty for both absolute and relative poor. In order to reduce poverty the author suggests several programmes such as additional family income; food for work, credit programmes for livestock, drought animals, small machinery and equipment, and crop projection; programmes for additional poor; policies to curb inflation; improvement in quality of life: and investment need both of the Banking sector as well as of Government sector.

The author mentions that the rise in cost of living due to inflation is to push up the

number below poverty line in 1980 and 1985 in comparison to 1977. Since inflation rate is always more than the national growth rate of gross National Product this will also push up the national average subsistence expenditure from Rs. 2.00 to Rs. 2.20 in 1980 and Rs. 2.50 a day/capita in 1985. As a result below as well as above poverty line population will continue to rise accompanied at the same time by the increase in the national average per capita consumption expenditure. The author projects during the period1977–1985 that just as the total poors increase the per capita income levels as well as the national average consumption expenditure also increase because of increasing inflation. Since poverty will be increasing continuously the reviewer does not see the relevance of prosperity in the title of the book.

The rationale of the whole book is based on the assumption that if such and such things happen in statistical terms the income of the poors will rise. These statements are incorporated with many forms of number such as households, population, income, percentages in terms of per family, per capita, per annum per household with respect to absolute poors, relative poors, and total poors. Thus in each page there are in an average 50 percent repeated numbers and 50 percent repeated statements. The author gives more data than analysis. This book of 114 pages was made forcibly long by including too many statements and definition of the same nature. As a matter of fact a twelve page summary in the first chapter with a couple of pages added for conclusion and bibliography would have described almost all the necessary items of the tables and all tables would deserve a handsome volume in appendix. The book itself is extremely poor for the price.

The book also bears many of the hallmarks of a contract final report. There are, for example, some serious typological errors, as on page 4 the projected population of 14.87 million is printed as 14.23 million. In chapter 2, footnote 1, absoluve poor should have been relative poor. Some inconsistent statistics are presented in table 3 and 4 particularly regarding the urban Nepal. The figures in pp.44-45 are not incorporated in the text and hence remain simply pictorial.

After a careful and critical reading I conclude that the book is all fanfare and no substance. It is scholarship of the S.C. Jain sort which typically produces such messes. It is the same poverty thing repeated so many times in his previous publications and that Jain leaves a great deal to be desused, for there are factual errors in the estimation of poors and some fundamental conceptual confusions regarding processes leading to poverty, as well as certain level of incoherence. It is never quite clear whether Jain is talking about the realities of poverty as experienced by individuals, groups and classes of people or the realities of poverty in the pronounce-

ments of government and other planning bodies. The author is imposing poverty on the Nepalese people without understanding the social and cultural enigma inhibiting them for centuries. He simply sits on 1981 as a traffic police and directs the estimated 1977 and 1980 so called poors towards the poverty depression of 1985 by saying that he is directing them to 1985 prosperity. The author never defines explicitly the meaning of prosperity that is so important to make his book more saleable.

I was almost expecting Jain to proclaim that he could see the light of prosperity at the end of the tunnels of poverty in Nepal in his conclusion–but the author had nothing to conclude.

For years Jain among others has played the role of technocratic whiz kid in rural poverty area but he has confused us more by writing more confusing books and every new book adds new confusions. For this matter, perhaps, he has made himself to be listened to as a policy-touting mandarin.

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